Baker McKenzie.

Tax News and Developments

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United States: Four IRS Notices Address OBBBA Ambiguities

In brief

In early December, Treasury and the Internal Revenue Service (IRS) released four notices (Notice 2025-72, Notice 2025-75, Notice 2025-77, and Notice 2025-78), announcing forthcoming proposed regulations that would address international tax law changes regarding the transition from the provisions of the Tax Cuts and Jobs Act (TCJA) to those of the One Big Beautiful Bill Act (OBBBA). Written comments on Notice 2025-72 are due on January 24, 2026, while comments on Notices 2025-75 and 2025-78 are due February 2, 2026. Notice 2025-77 does not include requests for comments.

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Key takeaways

- Notice 2025-72 addresses certain foreign tax accrual timing issues that arise from the short one-month 2025 taxable year created by the OBBBA's repeal of the One-Month Deferral Election in section 898(c)(2), which is relevant for Controlled Foreign Corporations (CFCs) that previously made the deferral election.
- Notice 2025-75 provides guidance under the transition rule the OBBBA included in its changes to the section 951(a) pro rata share rule, limiting an acquiring US shareholder's ability to reduce its pro rata share of the CFC's subpart F or tested income for dividends the CFC makes prior to an acquisition in 2025.
- Notice 2025-77 provides guidance clarifying that only distributions of PTEP arising from inclusions by a US shareholder as Net CFC Tested Income (NCTI) in taxable years ending before June 28, 2025 are subject to section 960(d)(4), requiring taxpayers to track pre- and post-06/28/25 previously taxed earnings and profits (PTEP) groups for compliance.
- Notice 2025-78 addresses technical questions that have arisen since the OBBBA's changes to exclude intangible property sales and sales of certain depreciable and amortizable property from qualifying as Foreign-Derived Deduction Eligible Income (FDDEI) eligible under section 250.

Notice 2025-72 – Guidance on foreign tax allocations

Notice 2025-72 ("**FTC Allocation Notice**") provides that forthcoming proposed regulations will be issued that will address allocating foreign taxes that are paid or accrued in the short one-month 2025 taxable year created by the repeal of the One-Month Deferral Election (section 898(c)(2)) and the Succeeding Taxable Year. The guidance aims to prevent mismatches of tax and income that could result in unfavorable outcomes for taxpayers that had previously made the One-Month Deferral Election.

Background

The OBBBA repealed section 898(c)(2), which had previously allowed specified foreign corporations (SFCs) to elect a taxable year beginning one month earlier than its majority US shareholder's taxable year ("**One-Month Deferral Election**"). SFCs are defined under section 898(b) as any foreign corporation that is treated as a controlled foreign corporation (CFC) and has a US shareholder that owns more than 50% of the stock of the CFC by vote or value.

The repeal, effective for SFC tax years that begin after November 30, 2025, requires an SFC that had previously made a One-Month Deferral Election to conform its taxable year to that of its majority US shareholder. For example, an SFC with a November 30, 2025 taxable year end would be required to close its subsequent taxable year on December 31, 2025. As a result, the SFC would have a one-month short taxable year as its "First Required Year" (within the meaning of section 898(c)(1)). Section 898(c)(1) defines the First Required Year as "the majority US shareholder year" or "if there is no majority US shareholder year, the taxable year prescribed under regulations." The SFC's "Succeeding Taxable Year" would begin January 1, 2026.

The repeal of section 898(c)(2), on its own, creates potential issues. Foreign net income taxes typically accrue based on a full taxable year of income at the close of the foreign taxable year. Therefore, assuming an SFC had a calendar fiscal year for foreign purposes, all foreign taxes for a full calendar 2025 year would generally accrue on December 31, 2025, which is after the CFC's US fiscal year (i.e., December 1, 2024 to November 30, 2025). As a result, these foreign taxes would fall into the short one-month US taxable year that resulted from the repeal of section 898(c)(2). This over-accrual of taxes could potentially create a loss for the SFC in that short one-month taxable year for US tax purposes. A US corporate shareholder is generally entitled to deemed paid foreign tax credits for current year foreign income taxes paid by its CFC that are properly attributable to amounts of a CFC's net subpart F income or tested income included in the US shareholder's gross income. Because the deemed-paid credit requires the taxpaying CFC to have net income in the income group to which the foreign tax is properly attributable, an SFC's net loss in an income group would cause the US shareholder not to be deemed to have paid any taxes for that income group with respect to the SFC in that short year. Congress anticipated this potential issue. Section 70352 of the OBBBA directed Treasury to "issue regulations or other guidance for allocating foreign taxes paid or accrued in [the one-month year] and the Succeeding Taxable Year among such taxable years in the manner the Secretary determines appropriate to carry out the purposes of this section."

Additionally, the repeal of section 898(c)(2) could affect how taxpayers recognize foreign currency gains and losses under section 987. Section 987 applies to taxpayers that operate a qualified business unit (QBU) with a functional currency other than the US dollar. Under section 987, taxpayers must account for the QBU's operations in the QBU's functional currency and translate income or loss into the US dollar. The taxpayer must also recognize exchange gains or losses when the QBU makes remittances to the taxpayer to the extent the value of the currency at the time of the remittance differs from the value when earned.[1]

The final section 987 regulations published in 2024 are applicable to taxable years beginning after December 31, 2024. The final regulations included rules for determining and recognizing section 987 gains or losses that arose before the section 987 regulations became applicable ("**Pretransition Gains or Losses**"). Taxpayers could elect to amortize Pretransition Gains or Losses over a period of ten taxable years beginning with the first taxable year in which the section 987 regulations apply. Because the repeal of section 898(c)(2) created a short one-month taxable year, the Pretransition Gains or Losses could be recognized over a compressed period.

The FTC Allocation Notice

Sections 3 and 4 of the FTC Allocation Notice provide rules for taxes that accrue in the short one-month taxable year. Treasury and the IRS have requested comments on whether other foreign taxes or other rules should apply over multiple years considering the short taxable year resulting from the repeal.

Allocation of foreign income taxes

Section 3 of the notice provides the following ordering rules for allocating foreign income taxes between the short one-month US taxable year ("**First Required Year**") and the calendar year beginning January 1, 2026 ("**Succeeding Taxable Year**"):

1. First, the SFC must determine specified foreign income taxes (SFITs). SFITs are the foreign net income taxes accrued by an affected SFC in its First Required Year for which the SFC is the taxpayer under Treas. Reg. § 1.901-2(f) (a section 901 taxpayer). As discussed above, an SFC that has a calendar year as its foreign fiscal year generally accrues its foreign income taxes on December 31, 2025, which is in its First Required Year.

[1] § 987(3)(B).

SFITs do not include, for example, withholding taxes, taxes paid by a partnership, or taxes accruing after December 31, 2025.

2. Second, the SFC must allocate and apportion the SFITs based on Treas. Reg. § 1.861-20 to income groups and PTEP groups described in Treas. Reg. § 1.960-1. The amount of SFIT assigned to any PTEP group is allocated to the First Required Year.

3. Third, the SFC must apply an allocation formula to the income groups to determine the amount of SFITs in each income group that is allocated to the First Required Year and the Succeeding Taxable Year. Here, the One-Month Deferral Notice provides a flexible method of effectively prorating 2025 foreign taxes between the short one-month period and the Succeeding Taxable Year. The allocation percentage used is derived from the principles of Treas. Reg. § 1.1502-76(b), which allows taxpayers to use either a closing of the books method or a ratable allocation method. If Treas. Reg. § 1.901-2(f)(5) applies (which addresses entity ownership or classification changes) and the affected corporation's period of ownership began on or before the beginning of the First Required Year, the denominator of the allocation percentage includes only the total taxable income attributable to the affected corporation's period of ownership.

Except as otherwise provided, the SFC must accrue the amounts of SFITs allocated to the First Required Year and the Succeeding Taxable Year in each respective year. For purposes of sections 905(c) (generally dealing with adjustments to accrued taxes) and 986(a) (generally dealing with translating foreign income taxes), if there is a change in SFIT liability, the taxpayer must adjust the SFIT accrued in the First Required Year to reflect the change and apply the ordering rules to the adjusted amount of SFIT.[2]. The approach in the One-Month Deferral Notice allows taxpayers to pro-rate the taxes over an extended period beyond the First Required Year, but also, inevitably, leads to an over inclusion of foreign taxes in the Succeeding Taxable Year as foreign taxes for 2026 generally would accrue on December 31, 2026, which is in the Succeeding Taxable Year, in addition to the allocation of December 31, 2025 foreign taxes to the Succeeding Taxable Year.

Section 7 of the notice provides an example, which is summarized here in the table below. CFCX is an SFC in Country X:

(1) Total SFITs (based on section 901)	**(2) Apply Treas. Reg. § 1.861-20 to allocate the SFITs to income groups.**	**(3) Allocation percentage**	**Amounts of Country X tax allocated to the First Required Year (applying the allocation percentage to the tax accrued in each income groups)**	**Remaining amount of Country X tax in each income group allocated to CFCX's Succeeding Taxable Year**
7,200u (12 months of foreign net income tax accrues in the short one-month US taxable year)	5,400u is allocated and apportioned to general category tentative gross tested income 1,800u is allocated to the general category foreign base company services income group (totaling 7,200u)	8.33% 3.750u (CFCX's taxable income attributable to CFCX's First Required Year (applying principles of Treas. Reg. § 1.1502-76(b)) divided by 45,000u (CFCX's total taxable income under Country X law for the 2025 calendar year)	600u 450u (8.33% * 5,400) + 150u (8.33% * 1,800u)	6,600u 4,950u assigned to the general category tentative gross tested income 1,650u allocated to the general category foreign base company services income group (totaling 6,600u)

[2] Notice 2025-72, § 6.

Amortization of foreign currency gains and losses

Section 4 of the One-Month Deferral Notice provides expected guidance for taxpayers that elected under the final section 987 regulations published in 2024 to amortize Pretransition Gains or Losses. Instead of recognizing one-tenth of the Pretransition Gains or Losses each year over ten years (one of which would be the one-month taxable year resulting from section 898(c)(2) repeal), Pretransition Gains or Losses would be amortized over a period of 120 months, beginning with the first day of the first taxable year in which the section 987 regulations apply.

Period of applicability

The proposed section 898 regulations are expected to apply to taxable years of SFCs beginning after November 30, 2025. Taxpayers may rely on the rules described in sections 3 and 4 of the notice in taxable years of SFCs beginning after November 30, 2025, and ending before the proposed regulations are published.

Notice 2025-75 – CFC pro rata share Transition Rule

On December 4, 2025, Treasury and the IRS released Notice 2025-75 ("**Transition Rule Notice**"), announcing their intent to issue proposed regulations implementing a transition rule ("**Transition Rule**") for purposes of determining US shareholders' pro rata shares of a CFC's income for CFC taxable years that include June 28, 2025. The notice addresses eligibility for a reduction to a US shareholder's pro rata share of CFC income based on distributions made by the CFC in the taxable year before the new pro rata share rules come into effect, which is taxable years beginning after December 31, 2025.

Background

Each US shareholder of a CFC is required to include its pro rata share of the CFC's current-year subpart F income and tested income (giving rise to a GILTI/NCTI inclusion). For taxable years beginning before December 31, 2025, section 951 required the US shareholders that owned the CFC's stock **on the last day** of the CFC's taxable year to include their pro rata shares of this income. If the US shareholder acquired the CFC's stock during the CFC's taxable year, however, section 951(a)(2)(B) provides for a reduction to the US shareholder's pro rata share of the CFC's income to account for dividends with respect to such CFC stock that had been made (or deemed made) to other persons.

The OBBBA changed the pro rata share rule for taxable years beginning after December 31, 2025 so that any US shareholder owning CFC stock at any point during the CFC's taxable year — whether or not on the last day of such year — would be required to include any subpart F or tested income "attributable" to the US shareholder's ownership of the CFC.

The OBBBA also included the Transition Rule, limiting what would be treated as "dividends" for purposes of the pro rata share reduction rule in section 951(a)(2)(B) for certain actual and deemed dividends paid by an acquired CFC in 2025.[3] Specifically, the Transition Rule provides that, except as provided by the Secretary, a dividend cannot decrease a US shareholder's pro rata share of its subpart F or GILTI under section 951(a)(2)(B) in two circumstances: (1) if the dividend is paid or deemed paid (a) on or before June 28, 2025, and during the taxable year of a CFC that includes that date, provided the US shareholder described in section 951(a) did not own the stock of the CFC during the portion of the taxable year on or before June 28, 2025, or (b) after June 28, 2025, and before a foreign corporation's first taxable year beginning after December 31, 2025 (e.g., a dividend paid before the end of 2025 for calendar year taxpayers), and (2) the CFC's dividend did not increase the taxable income of a US person subject to federal income tax. Congress specified that the failure of such a dividend to increase the taxable income of a US person could arise from, for example, a dividends received deduction (DRD) under section 245A, exclusion from gross income, or exclusion from a CFC's subpart F income. Congress directed Treasury to provide guidance on how this rule would be applied.

The Transition Rule Notice

The Transition Rule Notice describes how the proposed regulations will characterize dividends as either increasing or not increasing the taxable income of a US person subject to federal income tax by defining dividends, US persons subject to federal income tax, and increases in taxable income. The notice also addresses some questions taxpayers

[3] P.L. 119-21, §70354(c)(2)(B).

have raised since the Transition Rule's enactment, in particular with respect to how the rule will interact with the "extraordinary reduction" rules in Treas. Reg. § 1.245A-5(e), which limit the availability of the section 245A DRD upon certain dispositions of foreign corporation stock by US persons.

Dividends

The Transition Rule Notice unsurprisingly applies the same definition of dividends as that used for the prior version of section 951(a)(2)(B). Accordingly, the notice confirms that section 1248 deemed dividends will be treated as dividends paid for the purposes of the Transition Rule.[4]

The Transition Rule's explicit reference to a DRD makes this rule particularly relevant to GILTI and subpart F consequences resulting from M&A transactions. Specifically, when a US seller disposes of CFC stock, generally section 1248 requires the US seller to characterize its gain on the sale of stock as a dividend from the CFC up to the amount of the CFC's earnings. Section 245A provides a DRD with respect to a section 1248 deemed dividend paid to a seller that is a domestic corporation. When one CFC sells stock of another CFC, a companion rule in section 964(e) mandates the same deemed dividend and DRD-equivalent results. Thus, transactions involving sales of CFC stock directly or indirectly between US persons during 2025 (or fiscal years including June 28, 2025) are likely to suffer denial of pro rata share reduction under the Transition Rule, to the extent the US seller is entitled to a DRD for a deemed dividend or a selling CFC is able to exclude the deemed dividend from income.

US persons subject to federal income tax

When determining which US persons are subject to federal income tax, US persons generally are defined as provided in section 7701(a)(30). A look-through rule will apply to partnerships and S corporations not taxed at the entity level, shifting the analysis of whether there is an increase in taxable income from a dividend to the income of any partners or S corporation shareholders who are US persons. If there are multiple levels of pass-through entities, the look-through rule applies up the chain. Dividends allocated to a US person owning 5% or less of a domestic publicly traded partnership are treated as increasing the US person's taxable income unless the partnership has actual knowledge that the owner is not a US person or that the dividend does not increase such person's taxable income.[5]

Increase in taxable income

The definition of taxable income used is generally that set by Section 63, but for certain entities that are subject to tax on a different basis, such as nonprofits taxed on their unrelated business taxable income, taxable income will refer to that basis.[6] In determining if a dividend increases taxable income, any exclusions or DRDs are applied first.[7] The Transition Rule Notice includes an ordering rule providing that the extraordinary reduction rule of Treas. Reg. § 1.245A-5(e) applies first, such that denial of a DRD under that provision is considered to increase a US person's taxable income to the extent of the denial. In addition, the election in Treas. Reg. § 1.245A-5(e) to close the CFC's taxable year is still available, as is a section 338(g) election. These approaches remain viable ways for US parties to an M&A transaction to take the Transition Rule issue off the table. The OBBBA also included new section 951(a)(4), granting authority to issue regulations allowing or requiring taxpayers to close a CFC's taxable year upon disposition of the CFC. As this statutory provision is unrelated to the Transition Rule, however, such rulemaking is outside of the scope of the notice, and it remains to be seen how Treasury and the IRS will approach the year-closing issue.[8]

If a dividend increases taxable income by less than the full value of the dividend, as under partial exclusions or exemptions, the portion of the dividend that does not increase income is not treated as a dividend for section 951(a)(2)(B).[9] General deductions that are not tied to receipt of a dividend will not be involved in determining if there is an increase in taxable income.[10] The determination of whether a dividend increases taxable income of a US person is made on a share-by-share basis.[11]

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[4] Notice 2025-75, §3.02.

[5] Id., §3.03.

[6] Id., §3.03(3)(a).

[7] Id., §3.03(3)(b).

[8] Id., §3.03(3)(d)(ii).
[9] Id., §3.03(3)(c).

[10] Id., §3.03(3)(b).

[11] Id., §3.03(3)(c).

Reporting

During the period of applicability for the Transition Rule, a US shareholder that only owns CFC stock for the last portion of the CFC's year likely will prefer to reduce its pro rata share under section 951(a)(2)(B) with respect to the CFC's dividends on that stock to other persons. However, a US shareholder must establish that those dividends are treated as increasing another US person's taxable income. To that end, the Transition Rule Notice requires attaching a statement to Form 5471 identifying CFC dividends that qualify as dividends under the Transition Rule and explaining how the taxpayer determined that these dividends increased a US person's taxable income.[12] Because this information may be difficult to acquire, potential US buyers of CFC stock should consider including information sharing and cooperation requirements or otherwise addressing the issue in the sale agreement. Since many transactions subject to the Transition Rule have already been completed, those US buyers will need to approach the seller(s) post-close to request the required information.

Period of applicability

The forthcoming proposed regulations will apply to the taxable year of a CFC that includes June 28, 2025 and to taxable years of a CFC beginning after June 28, 2025, but before such CFC's taxable year beginning after December 31, 2025. Taxpayers may rely on the Transition Rule Notice until the proposed regulations are published.[13]

Notice 2025-77 – Section 951A PTEP distributions subject to 10% haircut

On December 4, 2025, Treasury and the IRS released Notice 2025-77 ("**PTEP Notice**"), which announces their intent to issue proposed regulations under section 960(d)(4) that would disallow an FTC for 10% of foreign income taxes on distributions of PTEP that arose from a NCTI inclusion. There was a question regarding the effective date language under this rule and whether 10% disallowance applies based on the date the NCTI inclusion occurred or the PTEP distribution was made. The PTEP Notice provides that the 10% FTC disallowance applies based on the date of the NCTI inclusion.

Background

The OBBBA made significant changes to the tested income inclusion regime under section 951A (formerly GILTI) and the allowance of deemed-paid foreign tax credits attributable to tested income under section 960(d). Section 960(d) was originally added to the Code by the TCJA.

The OBBBA renamed GILTI as "Net CFC Tested Income" (NCTI) and removed the "net deemed tangible income return" from the calculation, applicable to taxable years beginning after December 31, 2025. The deduction percentage for NCTI under section 250 is reduced to 40% (from 50%) and made permanent.

Further, the OBBBA reduced the haircut for the deemed-paid foreign taxes attributable to NCTI inclusions, from 20% to 10%, and the haircut for the associated section 78 gross-up is also decreased from 20% to 10%. The decrease in the NCTI section 250 deduction percentage and the foreign tax credit changes, taken together, increase the effective US tax rate to approximately 12.6% on NCTI, up from 10.5% on GILTI.

The OBBBA enacted new section 960(d)(4), which disallows a credit for 10% of the foreign income taxes paid or accrued with respect to a distribution to a US shareholder of PTEP arising from NCTI inclusions. Importantly, the new rule in Section 960(d)(4) applies to "foreign income taxes paid or accrued (or deemed paid under section 960(b)(1) of [the Code]) with respect to any amount excluded from gross income under section 959(a) by reason of an inclusion in gross income under section 951A(a) of such Code after June 28, 2025." The key unresolved question has been the practical meaning of the effective date — specifically, whether the section 960(d)(4) haircut applies to PTEP arising from section 951A **inclusions** occurring after June 28, 2025, or whether the rule applies to any **distribution** of section 951A PTEP made after June 28, 2025. If the latter reading were correct, the section 960(d)(4) haircut could apply to GILTI PTEP created years before a post-June 28, 2025 distribution.

The PTEP Notice

According to the PTEP Notice, the proposed regulations would provide that section 960(d)(4) applies to PTEP arising from section 951A inclusions that occur after June 28, 2025, and the relevant taxable year for determining the date of a

[12] Id., §3.03(4).

[13] Id., §4.

section 951A inclusion is that of the US shareholder. Therefore, section 960(d)(4) applies to PTEP created from a US shareholder's section 951A inclusions in taxable years ending after June 28, 2025. PTEP arising from a US shareholder's section 951A inclusions in taxable years ending before June 28, 2025 is not subject to section 960(d)(4). Overall, this is a taxpayer favorable result and one that aligns best with the new 10% NCTI haircut rules, which apply to taxable years beginning after December 31, 2025. Having the new PTEP haircut rule apply to distributions of PTEP from pre-OBBBA GILTI inclusions would have been unfairly punitive with de facto retroactive effect. Fortunately, under this guidance, the date of inclusion — i.e., when the PTEP arises — determines the applicability of the new haircut rule, not the date of the PTEP distribution.

To implement this rule, taxpayers must track whether a PTEP distribution is a from section 951A inclusions in taxable years ending before or after June 28, 2025. Therefore, the proposed regulations would require that the section 951A PTEP group be further divided into two categories: pre-June 29, 2025 section 951A PTEP and post-June 28, 2025 section 951A PTEP. An example in the PTEP Notice clarifies that the inclusion date is relevant for purposes of this distinction, not the timing of when a CFC earned the related tested income. For this determination, the rules of section 959(c) would apply. Similarly, for purposes of allocating and apportioning the foreign income taxes with respect to the PTEP distributions, rules under Treas. Reg section 1.861-20 would apply in conjunction with the expected proposed regulations.

Period of applicability

While the issuance of the proposed regulations is pending, taxpayers may rely on the guidance provided in the PTEP Notice. Taxpayers who choose to rely on the PTEP Notice must follow it in its entirety and apply it consistently for all applicable taxable years.

Notice 2025-78 – Income excluded from FDDEI

On 4 December 2025, Treasury and the IRS also released Notice 2025-78, announcing their intent to issue proposed regulations providing guidance with respect to the changes made by the OBBBA in section 250(b)(3) ("**FDDEI Notice**").[14] The changes generally exclude the sale of intangible property (IP) and any other property of a type that is subject to depreciation, amortization, or depletion by the seller from qualifying under the favorable foreign-derived deduction eligible income (FDDEI) regime, formerly known as the foreign-derived intangible income (FDII) regime. The notice anticipates that regulations will be issued addressing the scope of the newly added section 250(b)(3)(A)(i)(VII) and provides definitions and examples to clarify whether gains from the export sales of property are included in a domestic corporation's FDDEI calculation.

Background

The TCJA introduced a deduction under section 250 for domestic corporations that earn FDII. The FDII deduction allowed domestic corporations a deduction of 37.5% of the excess of the corporation's income from outbound property sales over a fixed return on its tangible depreciable assets for the year, i.e., its qualified business asset investment for the year (QBAI).[15] The starting point for the FDII calculation was deduction eligible income (DEI). DEI is the excess of the domestic corporation's gross income ("**Gross DEI**") for the year over deductions properly allocable to Gross DEI. Gross DEI includes all income except the following:[16]

- Any subpart F income and income from investments in US property included in gross income under section 951(a)(1);
- Any global intangible low-taxed income (GILTI) in pre-2026 tax years or NCTI in post-2025 tax years included in gross income under section 951A;
- Any financial services income;[17]
- Any dividend received from a CFC with respect to which the corporation is a US shareholder;

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[14] Pub. L. No. 119-21, § 70321-23.

[15] Former § 250(b)(2)(B) (effective through July 3, 2025).

[16] § 250(b)(3)(A).

[17] As defined in § 904(d)(2)(D) and Treas. Reg. § 1.904-4(e)(1)(ii).

- Any domestic oil and gas extraction income;[18]
- Any foreign branch income.[19]

In 2025, the OBBBA amended the FDII calculation by renaming it as FDDEI, removing the 10% fixed return on QBAI from the calculation, and adjusting the domestic corporation's DEI calculation.[20] For taxable years beginning after December 31, 2025, the section 250 deduction for a domestic corporation is equal to 33.34% of its FDDEI.[21] In determining its DEI, a domestic corporation is no longer permitted to include income and gain derived from (1) the sale or other disposition of IP and (2) any other property of a type that is subject to depreciation, amortization, or depletion by the seller.[22] For purposes of section 250 generally, income derived from "sales" has a special definition to include income from the lease or license of eligible property,[23] but the two new exclusions for sales of intangible property or other excluded property specifically do not use this special definition and, therefore, do not capture leases or licenses. Thus, a domestic corporation can still include income and gain from any lease or license of intangible property or other excluded property in its Gross DEI.[24] The new exclusions from Gross DEI apply to sales or other dispositions, including deemed sales or other deemed dispositions or transactions subject to section 367(d), occurring after June 16, 2025.[25]

Proposed definitions for Gross DEI exclusions

The FDDEI Notice addresses the scope of the two new exclusions from Gross DEI and provides definitions for terms used in section 250(b)(3)(A)(i)(VII). The FDDEI Notice defines intangible property by cross-referencing the intangible property definition in section 367(d)(4),[26] which defines intangible property as any:

- Patent, invention, formula, process, design, pattern, or know-how;
- Copyright, literary, musical, or artistic composition;
- Trademark, trade name, or brand name;
- Franchise, license, or contract;
- Method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data;
- Goodwill, going concern value, or workforce in place (including its composition and terms and conditions (contractual or otherwise) of its employment); or
- Other item the value or potential value of which is not attributable to tangible property or the services of any individual.

While the definition generally includes all forms of conventional intellectual property, the FDDEI Notice specifically provides that income and gain from the sale of copyrighted articles is not captured as part of the new rule. As a result, sales and leases of copyrighted articles qualify for FDDEI. Copyrighted articles are copies of digital content from which work can be perceived, reproduced, or communicated directly or with the aid of a machine.[27] Due to this rule in the FDDEI Notice, section 250 treats sales of copyrighted articles like sales of inventory.[28] Thus, income from the sale or lease of copyrighted articles is includible in Gross DEI.

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[18] As defined in § 907(c)(1), substituting "within the United States" for "without the United States."

[19] As defined in § 904(d)(2)(J) and Treas. Reg. § 1.904-4(f)(2).

[20] *See* § 250, as revised by OBBBA, Pub. L. 119-21, §§ 70321-70323.

[21] § 250(a)(1)(A).

[22] § 250(b)(3)(A)(i)(VII).

[23] § 250(b)(2)(E).

[24] § 250(b)(2)(E).

[25] Notice 2025-78, §4.

[26] Notice 2025-78, § 3.01(3).

[27] *See* Treas. Reg. § 1.861-18(c)(1).

[28] See §§ 861(a)(6), 862(a)(6), 863, and 865(a)-(c), (e).

Additionally, the FDDEI Notice provides a definition for "other excluded property," or property of a type that is subject to depreciation, amortization, or depletion by the seller, where income or gain on its disposition is excluded from Gross DEI.[29] Other excluded property means property which is not intangible property and that, in the hands of the seller, is or has been depreciable under section 167, amortizable, or depletable under section 611. [30] This portion of the FDDEI Notice was included in response to comments concerning taxpayers who had inventory property and were using the same type of property in their business and, thus, depreciating or amortizing the property. Taxpayers were unclear if the inventory property would no longer qualify for FDDEI because the property was of the same type in both cases. The FDDEI Notice clarified that the seller tracks the property by how the specific property is used, not generally by the type of property.

The FDDEI Notice also provides that a "sale or other disposition" means a sale or disposition as determined under general tax principles, including deemed sales, other deemed dispositions, and transfers of intangible property to foreign corporations subject to section 367(d).[31] Specifically, "deemed sales" and "deemed dispositions" include transactions or elections treated as sales or other dispositions of property for federal income tax purposes. This definition encompasses the imputed royalty payment rules of section 367(d)[32] and licenses transferring all substantial rights in property to the licensee, which are treated as sales for federal income tax purposes.[33] Importantly, a transaction characterized as a true lease or license under general tax principles is not a sale or other disposition.

The FDDEI Notice also includes an anti-abuse rule that applies to property that is not "other excluded property" when sold by the seller but was previously "other excluded property" in the hands of a related party. Specifically, the rule applies where property is transferred between members of a modified affiliated group, which have 80% ownership overlap, (1) in a transaction where seller acquires the property in a carryover basis transaction, such as a section 351 or 721 transaction, (2) the property was "other excluded property" in the hands of another member of the seller's modified affiliated group, and (3) was acquired by the seller with a principal purpose of avoiding the application of the rule that excludes income from other excluded property from Gross DEI.[34] As a result, the seller's ownership of the property instead of its related party does not "cleanse" the property of its status as other excluded property when it is subsequently disposed of to an unrelated party.

If the transferred property with a carryover basis is later sold by the transferee domestic corporation to an unrelated foreign person, the related-party anti-abuse rule applies to exclude the income and gain from the sale from the domestic corporation's DEI calculation.

Period of applicability

The anticipated regulations would apply when finalized to sales or other dispositions (including deemed sales, deemed dispositions, or transactions subject to section 367(d)) occurring after June 16, 2025. Until then, taxpayers may rely on Notice 2025-78 but must apply these rules in their entirety and in a consistent manner for all applicable taxable years.

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[29] Notice 2025-78, § 3.01(4).

[30] Notice 2025-78, § 3.01(5).

[31] Notice 2025-78, § 3.01(2).

[32] Section 367(d) provides that is a US person transfers intangible property to a foreign corporation in a tax-free exchange described in section 351 or 361, the intangibles will be treated as transferred pursuant to an ongoing, deemed royalty arrangement in which the transferor is treated as receiving imputed payments upon the productivity or use of the transferred property in amounts which reflect the amounts which would have been received annually over the useful life of the property.

[33] *See* Treas. Reg. § 1.1235-2(b)(1)-(3) (listing factors for determining whether all substantial rights to a patent have been transferred).

[34] Notice 2025-78, § 3.01(6).

Contact us

Julia Skubis Weber
Partner
julia.skubisweber@bakermckenzie.com

Julia Ushakova-Stein
Partner
julia.ushakova-stein@bakermckenzie.com

Additional authors

- Ege Berber, PhD, Associate
- Maxwell Holleman, Associate
- Ryan Murphy, Associate
- Julia Chiao, Associate